OPEN MEETING ITEM

ORIGINAL

0000049243

Executive Director

22

ARIZONA CORPORATION COMMISSION

DATE: April 26, 2006

DOCKET NOS.: W-01583A-04-0178, W-01583A-05-0326 and W-01583A-05-0340
TO ALL PARTIES:

Enclosed please find the recommendation of Administrative Law Judge Jane Rodda. The recommendation has been filed in the form of an Opinion and Order on:

LAS QUINTAS SERENAS WATER COMPANY

(RATES/FINANCING/ACRM)

Pursuant to A.A.C. R14-3-110(B), you may file exceptions to the recommendation of the Administrative Law Judge by filing an original and thirteen (13) copies of the exceptions with the Commission's Docket Control at the address listed below by **4:00 p.m.** on or before:

MAY 5, 2006

The enclosed is NOT an order of the Commission, but a recommendation of the Administrative Law Judge to the Commissioners. Consideration of this matter has tentatively been scheduled for the Commission's Open Meeting to be held on:

TO BE DETERMINED

For more information, you may contact Docket Control at (602)542-3477 or the Hearing Division at (602)542-4250. For more information about the Open Meeting, contact the Executive Director's Office at (602) 542-3931.

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BRIAN C. McNEIL
EXECUTIVE DIRECTOR

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

IN THE MATTER OF THE APPLICATION OF LAS QUINTAS SERENAS WATER CO. FOR A RATE INCREASE.	DOCKET NO. W-01583A-04-0178
IN THE MATTER OF THE APPLICATION OF LAS QUINTAS SERENAS WATER CO. FOR AUTHORITY TO INCUR LONG-TERM INDEBTEDNESS TO FINANCE WATER SYSTEM IMPROVEMENTS AND ASSURE COMPLIANCE WITH NEW ARSENIC RULES.	DOCKET NO. W-01583A-05-0326
IN THE MATTER OF THE APPLICATION OF LAS QUINTAS SERENAS WATER CO. FOR AN OPINION AND ORDER TO (i) RE-OPEN THE RECORD IN A RECENT RATE CASE SO AS TO CONSIDER EVIDENCE IN SUPPORT OF AN ARSENIC COST RECOVERY MECHANISM, AND (ii) MODIFY RATE CASE DECISION IN ORDER TO ADD AN ARSENIC COST RECOVERY MECHANISM AS AN AUTHORIZED RATE AND CHARGE.	DOCKET NO. W-01583A-05-0340 DECISION NO. _____ **OPINION AND ORDER**

DATE OF HEARING: March 1, 2006

PLACE OF HEARING: Tucson, Arizona

ADMINISTRATIVE LAW JUDGE: Jane L. Rodda

APPEARANCES: Mr. Lawrence V. Robertson, on behalf of Las Quintas Serenas Water Company;

Mr. John S. Gay, Intervenor, in propia persona; and

Mr. Jason Gellman, Staff Attorney Legal Division, on behalf of Commission Utilities Division.

BY THE COMMISSION:

* * * * * * * * * *

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

1. Las Quintas Serenas Water Company ("LQS" or "Company") provides water utility service to approximately 826 customers and an additional approximate 146 standpipe customers in an area around Sahuarita, Arizona.

2. Rules established by the United States Environmental Protection Agency ("EPA") require that the Maximum Contaminant Level ("MCL") for arsenic in potable water be reduced from 50 parts per billion ("ppb") to 10 ppb, effective January 23, 2006.

3. Recent tests of LQS's water supply indicate that all three of its wells are producing water that exceeds the EPA MCL for arsenic. Well No. 7 shows an arsenic level of 12 ppb; Well No. 6 has an arsenic concentration of 15 ppb; and Well No. 5 has an arsenic concentration of 10.4 ppb. (Ex. A-1 at 8).

4. On May 2, 2005, and May 12, 2005, LQS filed four inter-related documents with the Commission:

(a) A financing application to incur up to $1,789,375[1] in long-term debt in order to make capital improvements to address the new arsenic standards and other water system improvements (Docket No. W-01583A-05-0326)("Finance Application");

(b) A new application to re-open the record in its recent rate case (Docket No. W-01583A-04-0178) and amend Decision No. 67455 (January 4, 2005), so that the debt financing could be included in present rates for capital improvements not related to arsenic treatment (Docket No. W-01583A-05-0339);

(c) A new application to amend Decision No. 67455 so that the arsenic treatment costs related to the debt financing could be recovered through an Arsenic Recovery Mechanism ("ACRM")

[1] In its rebuttal testimony, the Company increased its cost estimates, and need for loan funds, to $1,889,168.

(Docket No. W-01583A-05-0340); and

(d) A Motion to re-open the recent rate case (Docket No. W-01583A-04-0178).

5. On May 25, 2005, Commission Utilities Division Staff ("Staff") filed a Response to the request to re-open Docket No. W-01583A-04-0178. Staff believed that the need for arsenic treatment was an extraordinary circumstance that warranted re-opening the rate case. However, Staff opposed re-opening the rate case for any other reason than to consider arsenic treatment.

6. On June 1, 2005, Staff filed a request to close Docket No. W-01583A-05-0339, because that Docket included a request to re-open the docket for non-arsenic related issues.

7. On June 14, 2005, LQS filed a Motion to Amend the Finance Application. LQS revised its financing request to $1,648,750, as it had discovered that $140,625 of its original financing request was related to non-arsenic capital improvements.

8. On June 23, 2005, the Commission convened a Procedural Conference to consider how it would proceed with the various requests before it. Staff continued to oppose re-opening the rate case to consider anything other than arsenic-related expenses. Although LQS continued to believe that portions of the financing request related to installing additional storage facilities should be considered, it agreed to further amend its Finance Application to bifurcate the two financing requests.

9. On July 7, 2005, LQS filed a Motion to Amend its Finance Application to remove that portion of the request related to non-arsenic related capital improvements.

10. By Procedural Order dated July 27, 2005, the Commission: re-opened Docket No, W-01583A-04-0178 pursuant to A.R.S. § 40-252; granted LQS's motion to amend its Finance Application; administratively closed Docket No. W-01583A-05-0339; consolidated the three remaining dockets; and established a procedural schedule for a hearing on the request for an ACRM.

11. By Procedural Order dated August 18, 2005, the Commission suspended the procedural schedule at the request of the parties.

12. On November 8, 2005, the Commission granted intervention to Mr. John Gay, a shareholder and customer of the Company.

13. On November 15, 2005, LQS and Staff jointly proposed a new procedural schedule.

By Procedural Order dated November 16, 2005, the Commission approved the proposed schedule and set a hearing to commence on March 1, 2006.

14. Pursuant to the November 16, 2005 Procedural Order, LQS mailed notice of the hearing on December 19, 2005 and caused the notice to be published in the *Green Valley News and Sun* on December 21, 2005.

15. On December 7, 2005, LQS filed the direct testimony and exhibits of Mike Wood, a Company board member; Mark Taylor, an engineer with Westland Resources, Inc.; Kimberly Yaglowksi, a banker; and Ron Kozoman, an accountant.

16. On January 25, 2006, Staff filed the direct testimony and exhibits of Daniel Zivan and Dorothy Haines.

17. Mr. Gay filed direct testimony on January 26, 2006.

18. On February 21, 2006, LQS filed the rebuttal testimony of Mike Wood, Mark Taylor and Ron Kozoman.

19. The hearing convened before a duly authorized Administrative Law Judge on March 1, 2006, at the Commission's Tucson offices.

20. The Commission received eight written comments from customers opposed to spending $1.6 million for arsenic treatment and supporting the purportedly less expensive proposal advanced by Mr. Gay. At the commencement of the hearing, one individual, a shareholder of the Company, appeared to give public comment and submitted a letter on behalf of herself and her sister opposing the more expensive proposal.

21. The parties agree that the Company must comply with the EPA arsenic regulations; that the Company does not have the ability to internally finance the necessary capital improvements; and there is a need for an ACRM/ARSM[2] to obtain funds through rates and charges to service borrowing costs associated with arsenic treatment.

22. The parties disagree about the scope of capital improvements that are necessary for an arsenic treatment system; the costs of the arsenic treatment improvements and the type of long-term

[2] Arsenic Recovery Surcharge Mechanism.

borrowing arrangement that should be approved.

23. LQS proposes to construct a combined treatment system for Well Nos. 6 and 7, and a separate treatment system for Well No. 5. Under the plan, a new dedicated raw water main from Well No. 7 will bring raw water to the arsenic treatment plant at Well No. 6 for treatment. Both Wells Nos. 6 and 7 will pump raw water through the treatment facility at Well No. 6 and a combination of blended and treated water will fill a new onsite storage reservoir. A new booster station will pump the treated water from the reservoir into the water system. Control of the booster station will be based on the level of water in the existing highwater storage tanks. The Company plans a backup generator to supply the system with treated water during emergencies. The Company determined that an absorption media arsenic removal process was the best means of treatment for the system, and selected Severn Trent as the vendor. Under this method, ferric oxide absorption media removes arsenic from the water by absorbing arsenic onto the surface of the media. The non-treated water is pumped through a pressure vessel containing the absorption media. LQS's engineer consultant testified that the exhausted media can be discarded in landfills and is classified as non-hazardous waste. The major capital improvements for this system are steel pressure vessels and a backwash tank.

24. As its final position, LQS proposes to construct the following capital improvements[3] associated with its planned arsenic treatment system:

Site Demolition	$12,500
Site Piping Well Site No. 6	92,000
Concrete Slabs	18,000
12 inch main between Wells Nos. 6 and 7	199,125
250,000 gallon Storage reservoir	190,000[4]
transfer booster station	220,000
1,290 gpm absorption arsenic treatment system	400,000

[3] Cost estimates taken from Taylor rebuttal testimony.

[4] The Company had originally included a 400,000 gallon storage tank at an estimated cost of $270,000, but revised its estimate downward to include a 250,000 gallon tank in response to Staff's opposition to recovering the cost of the 400,000 gallon storage tank as part of the arsenic treatment recovery mechanism.

backwash holding tank - Well No. 6	25,000
200 gpm absorption treatment system – Well No 5	150,071
Well No. 5 backwash tank	4,000
130 KW back-up generator at Well No. 6	60,000
Fencing Well Site No. 6	43,000
Well pump modifications Well Nos. 6 & 7	30,000
3 chlorination units	6,000
3 sand separators	13,827
3,000 gallon pressure tank Well No. 6	20,000
Electrical	47,800
Air compressor	5,000
Disinfection and testing	5,000
Total	1,541,323
Tax @ 5.59 %	86,160
Bond	10,800
Subtotal	1,638,313
15% engineering and contingencies	245,747
Total	1,884,060

The Company's costs are based on the estimates provided by Smyth Steel, a southern Arizona based contractor.

25. Mr. Gay hired Miller Brooks Environmental, Inc. ("Miller Brooks"), an engineering firm, to design a treatment system that would treat the arsenic at each well rather than by means of a centralized system as recommended by Westland Resources. Mr. Gay asserts that his proposal would have a capital cost of $580,000. (Ex I-1, G 4). The Miller Brooks proposal utilizes the same method of absorption treatment as utilized in the LQS proposal.

26. During the hearing, Mr. Gay testified that he believed that the best course of action for LQS would be for it to be acquired by its much larger neighboring water company -- Community Water Co., as the economies of scale of treating arsenic could be spread over a larger number of

consumers. (TR at 194). Mr. Gay introduced evidence consisting of newspaper articles that mention a possible offer by Community to buy LQS.

27. LQS states that the Miller Brooks report presents a feasible concept for arsenic treatment, but that it omits portions of the system that LQS believes are necessary such as flow control, chlorination, sand separation and back-up power. LQS believes the Miller Brooks proposal did not consider the water system as a whole and assumed that all of the work would be either self-performed by LQS or subcontracted to local contractors. Specifically, LQS states that Miller Brooks was not asked to: 1) perform site visits to confirm information or identify site-specific construction factors; 2) determine if other solutions would better fit the overall LQS system; 3) analyze the existing water system for deficiencies; 4) identify water system issues that could be intensified by implementation of the plan; or 5) determine the effect of the proposed improvements on the existing system.

28. LQS also argues that the Miller Brooks cost estimates do not allow for an "apples-to-apples" comparison with the LQS proposal as they use different assumptions. LQS states that it assumed that LQS would publicly bid the plans for the combined treatment system at Wells Nos. 6 and 7 due to the complexity of the system which would require a significant construction effort to assemble. LQS assumed that LQS would install the small packaged system for Well No. 5. Miller Brooks assumed that LQS would perform most of the construction at all three sites. In addition, LQS asserts that the Miller Brooks estimate: 1) does not allow a mark-up for the labor costs for a general contractor; 2) does not allow for the costs of equipment, such as cranes, that would be needed to install the plant; 3) does not include shipping costs from Pittsburgh, Pennsylvania; 4) does not include appropriate unit costs for short length of piping and installation in a retrofit situation where hand-digging may be required; 5) does not include chlorination equipment; and 6) does not include sand equipment.

29. LQS had Smyth Steel perform a cost estimate of the Miller Brooks proposal which indicates the Miller Brooks proposal would incur construction costs of $1,055,913, before a 15 percent allowance for engineering and contingencies costs. Based on the Smyth Steel analysis, LQS estimates that the Miller Brooks design would have a total cost of $1,214,000. (Ex AR-11 Taylor

Rebuttal at 5.)

30. LQS criticizes the Miller Brooks proposal because it does not achieve both of LQS's goals of 1) complying with EPA standards and 2) continuing to provide adequate and reliable water service to customers. While LQS acknowledges that the Miller Brooks proposal results in water that complies with EPA arsenic standard, it argues that the proposal does not address factors that LQS believes are integral to system reliability, namely storage, excessive pressures and well capacity.

31. LQS states it has received no offer of purchase from Community Water, and argues that the newspaper articles are unsubstantiated hearsay.

32. Staff concurs that the Company's selected treatment option is appropriate for the LQS system, but does not believe that all the items included in the Company's proposal for an ACRM are appropriate. Staff recommends excluding the 400,000 gallon storage tank, installation of the emergency backup generator, and the chlorination units. Staff's calculations show that the Company has adequate storage and production capacity at this time and that the Severn Trent system does not require storage capacity in its arsenic removal process. Staff states the emergency generator is not required for the proper operation of the arsenic treatment system, and the Severn Trent system does not require that disinfection occur before delivering treated water.

33. In addition, Staff recommends cost adjustments to several of the items. Staff utilized statewide averages to recalculate the costs of some of the components of the treatment system. Specifically, Staff estimated that rather than $65 per foot for the 12-inch main, the cost should be closer to $36.70 per foot. Staff also believed that the cost of the backwash tanks should be reduced from $25,000 to $13,400 for the 13,400 gallon tank at Well No. 6 and from $4,000 to $3,600 for the 3,000 gallon tank at Well No. 5. Staff further reduced the cost of the 3,000 gallon pressure tank from $18,000 to $12,000.[5] Consequently, Staff concluded that the Company's Arsenic Treatment Project, as adjusted to reflect Staff's recommendations, is reasonable. Staff's recommended adjustments to the Company's proposal are as follows:

Site Demolition	$ 10,000

[5] Staff utilized the estimates provided in the Company's direct testimony and not the revised estimates resulting from the Smyth Steel review.

Site Piping Well Site No. 6	100,000
Concrete Slabs	14,000
12 inch main between Wells Nos. 6 and 7	91,750
250,000 gallon Storage reservoir	0
transfer booster station	120,000
1,290 gpm absorption arsenic treatment system	500,000
backwash holding tank - Well No. 6	13,400
200 gpm absorption treatment system – Well No 5	104,000
Well No. 5 backwash tank	3,600
130 KW back-up generator at Well No. 6	0
Fencing Well Site No. 6	40,000
Well pump modifications Well Nos. 6 & 7	15,000
3 chlorination units	0
3 sand separators	21,000
3,000 gallon pressure tank Well No. 6	12,000
Electrical	--
Air compressor	--
Disinfection and testing	--
Subtotal	1,059,750
25% engineering and contingencies	264,938
Total	1,324,688

34. Staff did not analyze the Miller Brooks proposal in depth and believed that it was not sufficiently detailed to allow Staff to formulate an opinion whether it would be an adequate solution to the problem. (TR at 241-42).

35. In addition to developing alternatives for arsenic reduction in each of the three wells, LQS states it identified additional factors that it believes are integral to system reliability and operation and which could be affected by the methodology selected for arsenic treatment. The

factors that LQS identified are (a) adequate storage volume; (b) excessive operating pressures in the water system due to small pipeline sizes; and (c) the effect of increased pressure losses through the arsenic treatment system on wellhead pressure and well capacity.

36. The Company argues that additional storage should be included for recovery as part of the ACRM because it provides operational reliability and serves as a finished water holding tank for the combined arsenic treatment product for Wells Nos. 6 and 7. Under this system, the pump system will be able to deliver potable water into the system at a rate commensurate with the rate at which it is being used by the system, which would reduce system operating pressures. (Ex AR-1, Taylor Rebuttal at 8)

37. The Company argues the backup generator is necessary to the effective operation of the arsenic treatment facilities as it would provide a method of accessing the treated water during a power outage. LQS estimates that the Company's current storage capacity of 90,000 gallons would provide only two hours of water supply if an outage occurred during peak hour demand and the tanks were full.

38. LQS argued that the hypochlorite chlorination units not only disinfect the water, but perform a specific benefit to arsenic treatment. Chlorination prior to arsenic treatment oxidizes the arsenic compounds from As (III) to As (V), which is the form of arsenic most readily absorbed in the absorption process.

39. Furthermore, the Company argues the Smyth Steel estimates are more accurate estimates of the actual costs of the system than the statewide averages utilized by Staff.

40. We agree with Staff that only investment needed for the treatment of arsenic should be included in the ACRM. In this case, we find that the storage tank and back-up generator are not related to the treatment of arsenic, but that the chlorinator units, which are recommended by the manufacturer and assist in the treatment process, are appropriately included. We find further, that the Smyth Steel cost estimates are the best estimates of actual project costs, and use these estimates to determine the cost of the arsenic treatment plant for purposes of evaluating the amount of financing authority to approve and the calculation of the ACRM.

41. In removing the additional storage and back-up generator from the treatment facilities

included in the ACRM, we are not making a finding that these investments would not be prudent. In weighing all the evidence, however, we find that the storage tank and back-up generator components of the Company's proposal are related to overall system reliability rather than to arsenic treatment, and as such are not properly included in the ACRM.

42. Based on the best available information, we approve financing authority for the installation of arsenic treatment facilities in an amount up to $1,580,446, determined as follows:

Company estimate	$ 1,541,323
Less Storage	(190,000)
Less generator	(60,000)
Subtotal	1,291,323
Tax at 5.59%	72,185
Bond	10,800
	1,374,308
15 % contingency	206,146
Total	1,580,446

43. Recovering costs by means of a surcharge does not provide an incentive for any Company to keep costs low. The Company indicated that it would place the project out for bid, and we expect the Company to use its best efforts to keep costs of the project as low as possible while still constructing an effective treatment plant. Because we do not include additional storage in the ACRM, the Company will need to determine whether it will install the storage it has proposed. In the event the Company elects not to install the additional storage it proposed in this proceeding, there would be no advantage to transporting the water from Well No. 7 to Well No. 6 for treatment, and consequently treating the arsenic at each wellhead would be the lower cost option.[6] The Company has estimated that the cost of the Miller Brooks proposal for treating the water at each wellhead would be $1,214,000. Additionally, under either option, if actual costs of construction are lower than the financing authority granted herein, the ACRM surcharge should be reduced to reflect actual financing costs rather than the face amount of the loan.

44. LQS testified that following Commission approval of this request, it will take eight

[6] There is an advantage of holding the treated water in storage, as it would decrease pressures on the wellheads from arsenic treatment and thus reduce wear on the pumps and extend equipment life. We do not find that this advantage is sufficient to include the cost of additional storage in the ACRM, but will include the capital costs associated with transporting the water for treatment as proposed.

months to complete the installation of the arsenic treatment facilities. LQS is required to meet compliance with the arsenic MCLs in the first quarter of 2007. (TR at 132-133). The Company must take action to treat its arsenic as soon as possible.

45. We find that there is no reliable evidence that Community Water has, or will, make a bid to purchase LQS within a timeframe that would allow LQS to meet its obligation to treat its water for arsenic.

46. LQS proposes to borrow the funds necessary to finance the acquisition and installation of the arsenic treatment facilities from the Arizona Water Infrastructure Authority ("WIFA"), or from Commerce Bank of Arizona ('Commerce Bank").

47. LQS originally proposed to obtain a loan from WIFA, and that in the event WIFA could not, or would not, approve the loan request in time for LQS to commence construction of the planned facilities, LQS was seeking authority to borrow the funds from Commerce Bank. During the course of the proceeding, however, it became less clear that the Company was advocating the WIFA loan as its preferred choice. Although the WIFA loan would likely have a lower monthly payment, the shorter term of the Commerce Bank loan (10 years versus 20 years for the WIFA loan), means that over the life of the loan, the Company, and ultimately ratepayers, would pay less with the bank loan. The Company is ambivalent and leaves to the Commission to determine which financing option should be approved.

48. The Company currently has a capital structure consisting of 100 percent equity. Borrowing $1,580,446, would result in a capital structure composed of 80.6 percent debt and 19.4 percent equity.

49. A WIFA loan is expected to have a term of 20 years and an estimated interest rate of 7.6 percent annually (80 % of prime plus 2%).[7] Borrowing $1,580,446 from WIFA on these terms, would result in a monthly payment of $12,829. There is no origination fee associated with the WIFA loan, but WIFA would require that the Company maintain a loan reserve equal to 20 percent

[7] For purposes of this proceeding, the parties assume that the WIFA subsidy would be 20 percent, however, WIFA may approve a greater subsidy of 25 or 30 percent.

of the principal.[8]

50. A loan from Commerce Bank would have a term of 10 years and an interest rate of 8 percent annually. Borrowing $1,580,446 from Commerce Bank on these terms would result in a monthly payment of $19,175. The Commerce Bank loan requires closing costs of $12,153 (.75% x loan amount + $300).

51. Staff recommended that the Commission authorize LQS to borrow $1,324,688 from WIFA and did not recommend approval of the loan from Commerce Bank. Staff believed that the lower monthly debt cost associated with the proposed WIFA loan made it the more attractive alternative. Staff states that WIFA has never denied a loan request such as this and Staff did not believe the Company required authority to borrow from Commerce Bank as a back-up position. (TR at 253).

52. Staff concluded that authorizing the WIFA debt would be lawful and within the corporate powers of LQS, compatible with the public interest, consistent with sound financial practices, and would not impair LQS's ability to provide service if an arsenic removal surcharge mechanism is adopted.

53. The parties do not dispute the formula for determining the ACRM. A copy of Staff's proposed methodology for calculating the ACRM is attached hereto as Exhibit A.

54. Assuming a WIFA loan of $1,580,446 at 7.6 percent interest for 20 years and utilizing the methodology of calculating the ACRM as set forth in Exhibit A, the ACRM for the 5/8 inch meter would be approximately $13.99 per month.[9]

55. Assuming a Commerce Bank loan of $1,580,446 at 8 percent for 10 years, and utilizing the methodology of calculating the ACRM as set forth in Exhibit A, the ACRM for the 5/8 inch meter would be approximately $22.27 per month.

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[8] A 20 percent loan reserve would be $316,089, which would require a $5,268 deposit each month for the first five years of the loan.

[9] This ACRM calculation is provided as a means to compare the effect of the two loan proposals. The calculations set forth herein utilize Staff's methodology, but employ the equivalent bill count that includes standpipe customers as set forth in the rebuttal testimony of Ron Kozoman (Ex AR-9). The parties utilized different equivalent bill counts, possibly because they used customer counts at different points in time. (TR 276) Staff agrees that all customers, including standpipe customers should be included in the determining the surcharge amount. Testimony indicates that a new subdivision is currently under development which has the potential of adding 234 additional residential units. (TR at 72).

56. We are concerned with the impact of the surcharge on ratepayers. Thus, we authorize the Company to borrow up to $1,580,446 from WIFA for the purpose of acquiring and installing arsenic treatment facilities. The monthly loan service payments associated with the WIFA loan are substantially lower, and will result in a lower monthly surcharge, than those of the Commerce Bank loan. In the event WIFA does not approve the loan request through no fault of the Company, LQS shall notify the Commission and requires this matter be reconsidered for the sole purpose of addressing the financing authority. The Commission will consider such request as expeditiously as possible.

57. Staff further recommends:

(a) authorizing an arsenic removal surcharge mechanism in order to provide LQS with a mechanism for applying for a surcharge to meet debt service requirements associated with the proposed financing;

(b) That LQS file the arsenic surcharge filing within 15 days of the loan closing;

(c) That LQS be required to calculate its proposed surcharge tariff using the actual loan principal and interest components and the same methodology that Staff used to determine the estimated surcharge amount in its testimony in this proceeding;

(d) That the Company engage in any transactions and to execute any documents necessary to effectuate the authorizations granted; and

(e) That the Commission deny the Company's request to recover $21,000 in annual operations and maintenance expense.

58. Our approval of the ACRM process, as outlined in this Order, recognizes that LQS faces significant costs in the next several years to comply with the EPA's new arsenic MCL standards. The impact on LQS, will be significant. Absent the implementation of an ACRM, the only viable alternative would be a series of rate applications and the possibility that interim rate relief would be required to maintain the Company's financial integrity until rate relief could be granted.

59. In order to insure the appropriate application of the ACRM, upon completion of the project, the Company should file as a compliance item in this docket, complete documentation of

actual costs for the construction of the arsenic treatment facilities approved herein. Staff shall review the documentation and determine whether the actual costs warrant a reduction in the ACRM surcharge.

CONCLUSIONS OF LAW

1. LQS is a public service corporation within the meaning of Article XV of the Arizona Constitution and A.R.S. §§40-250 and 40-251.

2. The Commission has jurisdiction over LQS and of the subject matter of the issues raised in the Company's request for an ACRM.

3. Notice of the application was provided in the manner prescribed by law.

4. Approval of the ACRM, as set forth herein, is consistent with the Commission's authority under the Arizona Constitution, ratemaking statutes, and applicable case law.

5. Approval to borrow up to $1,580,446 from WIFA for the purpose of financing arsenic treatment facilities, is compatible with the public interest, with sound financial practices, and with the proper performance by LQS of service as a public service corporation.

6. Staff's recommendations set forth in Findings of Fact No. 57 are reasonable and should be adopted, and approval of the ACRM is specifically conditioned on compliance with these Staff recommendations.

ORDER

IT IS THEREFORE ORDERED that Las Quintas Serenas Water Company's application for an Arsenic Cost Recovery Mechanism is approved, to the extent described herein.

IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall, in conformance with Staff's recommendations, make an arsenic surcharge recovery filing within 15 days of the loan closing.

IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall calculate its proposed surcharge tariff using the actual loan principal and interest components and the methodology set forth in Exhibit A.

IT IS FURTHER ORDERED that Las Quintas Serenas Water Company is authorized to borrow up to $1,580,446 from the Arizona Water Infrastructure Finance Authority for a term of 20

years at the then prevailing interest rate.

IT IS FURTHER ORDERED that the finance authority granted herein shall be expressly contingent upon Las Quintas Serenas Water Company's use of the proceeds for the purposes stated in its Application.

IT IS FURTHER ORDERED that Las Quintas Serenas Water Company is authorized to execute any documents necessary to effectuate the authorization granted.

IT IS FURTHER ORDERED that approval of the financing set forth hereinabove does not constitute or imply approval or disapproval by the Commission of any particular expenditure of the proceeds derived thereby for purposes of establishing just and reasonable rates.

IT IS FURTHER ORDERED that Las Quintas Serenas Water Company shall use its best efforts to keep the costs of its arsenic treatment plant as low as reasonably possible and shall file with Docket Control, as a compliance item in this docket, complete documentation of the actual costs of the acquisition and installation of the arsenic treatment facilities approved herein. Staff shall review the documentation and determine whether actual costs are lower than the approved loan amount and warrant a reduction in the ACRM surcharge.

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IT IS FURTHER ORDERED that operating expenses associated with the arsenic treatment system approved herein shall not be recovered as part of the ACRM.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

CHAIRMAN COMMISSIONER

COMMISSIONER COMMISSIONER COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this _____ day of _____, 2006.

_____
BRIAN C. McNEIL
EXECUTIVE DIRECTOR

DISSENT _____

DISSENT _____

JR:mj

SERVICE LIST FOR: LAS QUNITAS SERENAS WATER COMPANY

DOCKET NO.: DOCKET NO. W-01583A-04-0178
DOCKET NO. W-01583A-05-0236
DOCKET NO. W-01583A-05-0340

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Phoenix, Arizona 85007

Ernest Johnson, Director
Utilities Division
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1200 W. Washington Street
Phoenix, Arizona 85007

Las Quintas Serenas Water Co.
Docket No. W-01583A-05-0326 and W-01583A-05-0340
Application for Financing

Instructions to Calculate the Annual Surcharge Revenue Requirement on the Loan

Step 1. Find the Annual Payment on the Loan
Refer to Table A, the Conversion Factor Table. Reading the table from top to bottom, find the interest rate in column A that is equal to the stated annual interest rate of the loan. Reading across the table, find the Annual Payment Conversion Factor in Column B that corresponds with the loan interest rate (in the event that the loan interest rate is different from the interest rates in Table A, use the next higher interest rate that can be found in Table A). Multiply that annual payment conversion factor by the total amount of the loan to calculate the annual debt service on the loan.

Annual payment conversion factor
(*) Times total amount of the loan
(=) Equals annual debt service on the loan

Step 2. Find the Annual Interest Payment on the Loan
Refer to Table A and find the annual interest payment conversion factor in Column C that corresponds with the stated annual interest rate of the loan. Multiply the annual interest payment conversion factor by the total amount of the loan to calculate the annual interest expense on the loan.

Annual interest payment conversion factor
(*) Times total amount of the loan
(=) Equals annual interest expense on the loan

Step 3. Find the Annual Principal Payment on the Loan
Refer to Table A and find the annual principal payment conversion factor in Column D that corresponds with the stated annual interest rate of the loan. Multiply the annual principal payment conversion factor by the total amount of the loan to calculate the annual principal payment on the loan.

Annual principal payment conversion factor
(*) Times total amount of the loan
(=) Equals annual principal payment on the loan

DECISION NO. _____

EXHIBIT A

Las Quintas Serenas Water Co.
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Step 4. Find the *Gross Revenue Conversion Factor*[1] (GRCF)
The GRCF calculated below is used in step 5.

$$GRCF = \frac{1}{1 - \text{Effective incremental income tax rate}^2}$$

$$GRCF = \frac{1}{1 - 0.2918} = \frac{1}{0.7082} = 1.4120$$

Step 5. Find the Incremental Income Tax Factor
The incremental income tax factor is calculated below:

Incremental Income Tax Factor = GRCF - 1

= 1.4120 - 1

= 0.4120

Step 6. Find the Annual Income Tax Component of the Surcharge Revenue
Multiply the incremental income tax factor by the annual principal payment on the loan determined in step 3 to calculate the income tax component of the annual surcharge revenue.

Incremental income tax conversion factor
(*) Times the annual principal payment on the loan
(=) Equals the annual income tax component of the annual surcharge revenue

Step 7. Find the Debt Service Component of the Annual Surcharge Revenue
Add the annual interest expense on the loan determined in step 2 to the annual principal payment determined in step 3. The sum is the debt service component of the annual surcharge revenue.

Annual interest payment on the loan
(+) Plus annual principal payment
(=) Equals the debt service component of the annual surcharge revenue

[1] The gross revenue conversion factor indicates the incremental revenue required to increase operating income by one dollar.
[2] The effective income tax rate represents the effective tax rate on the incremental income. Use the effective incremental income tax rate of 29.1762%.

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Step 8. Find the Total Annual Surcharge Revenue Requirement Needed for the Loan.
Add the annual income tax component determined in step 6 to the annual debt service component determined in step 7. The sum equals the annual surcharge revenue requirement for the loan.

Annual income tax component of the surcharge revenue
(+) Plus annual debt service component of the surcharge revenue
(=) Equals the total annual surcharge revenue requirement for the loan

Instruction for Step 9
Step 9. Find the equivalent bills.
Multiply the NARUC meter capacity multiplier by the number of current customers and by the number of months per year. The sum of the products equals the equivalent bills.

Result

Col A	Col B	Col C	Col D	Col E
Meter Size	NARUC Meter Capacity Multiplier	Number of Customers	Number of Months In Year	Equivalent Bills Col B x C x D
5/8"x 3/4" Meter	1	0	12	0
3/4" Meter	1.5	0	12	0
1" Meter	2.5	0	12	0
1½" Meter	5	0	12	0
2" Meter	8	0	12	0
3" Meter	15	0	12	0
4" Meter	25	0	12	0
6" Meter	50	0	12	0
			Total	**0**

Instruction for Step 10
Step 10. Find the monthly surcharge for 5/8" x 3/4" customers.
Divide the result obtained in step 8 by the number of equivalent bills calculated in step 9 to obtain the monthly surcharge for 5/8" x 3/4" customers.

Result

$140,300	Total annual surcharge revenue requirement for the loan (Step 8)
÷ 10,920	Number of equivalent bills
$ 12.85	Total monthly surcharge for 5/8" x 3/4" customers

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Instruction for Step 11
Step 11. Find the monthly surcharge for remaining meter size customers.
Multiply the Result obtained in step 10 by the NARUC meter capacity multipliers to obtain the monthly surcharges for all other meter sizes.

Col A	Col B	Col C	Col D
Meter Size	NARUC Meter Capacity Multiplier	5/8" x 3/4" Customers' Surcharge	Surcharge by Meter Size Col B x C
5/8"x 3/4" Meter	1	$0.00	$ 0.00
3/4" Meter	1.5	$0.00	$ 0.00
1" Meter	2.5	$0.00	$ 0.00
1½" Meter	5	$0.00	$ 0.00
2" Meter	8	$0.00	$ 0.00
3" Meter	15	$0.00	$ 0.00
4" Meter	25	$0.00	$ 0.00
6" Meter	50	$0.00	$ 0.00

Las Quintas Serenas Water Company Schedule DTZ-3
Docket No.'s W-01583A-05-0326 and W-01583A-05-0340
Test Year Ended September 30, 2003

TABLE A

Conversion Factor Table (Based on a 20-year Loan)

1	3.50%	0.0696	0.0344	0.0352
2	3.75%	0.0711	0.0369	0.0342
3	4.00%	0.0727	0.0394	0.0333
4	4.25%	0.0743	0.0419	0.0324
5	4.50%	0.0759	0.0444	0.0316
6	4.75%	0.0775	0.0468	0.0307
7	5.00%	0.0792	0.0493	0.0299
8	5.25%	0.0809	0.0518	0.0291
9	5.50%	0.0825	0.0543	0.0283
10	5.75%	0.0843	0.0568	0.0275
11	6.00%	0.0860	0.0593	0.0267
12	6.25%	0.0877	0.0618	0.0259
13	6.50%	0.0895	0.0643	0.0252
14	6.75%	0.0912	0.0668	0.0245
15	7.00%	0.0930	0.0692	0.0238
16	7.25%	0.0948	0.0717	0.0231
17	7.50%	0.0967	0.0742	0.0224
18	7.75%	0.0985	0.0767	0.0218
19	8.00%	0.1004	0.0792	0.0211